IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 327 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI
and
Hon'ble MR.JUSTICE A.R.DAVE

==========

1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

1 & 2 Yes
3 to 5 No

COMMISSIONER OF INCOME-TAX

Versus

MAHARAJA EXHIBITORS

Appearance:
MR AKIL QURESHI for MR MANISH R BHATT for Petitioner
MR DA MEHTA with MR RK PATEL for the Respondent

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE A.R.DAVE

Date of decision: 01/08/2000

ORAL JUDGEMENT

(per A.R. Dave, J.)

At the instance of the revenue, the following two questions have been referred to this court for its opinion under the provisions of section 256(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act').

1. Whether, on the facts and in the circumstances of the case, and in law, the Tribunal was right in holding that the I.T.O. not having mentioned in draft order submitted to I.A.C. under section 144B of the I.T. Act about charging of interest under sec. 139(8) and 217 (1A), no order for levy of the said interest could have been made in the final order passed thereafter with prior approval of the Inspecting Asstt. Commissioner of Income-tax?

2. Whether, on the facts and in the circumstances of the case and in law, the Tribunal was right in holding that the I.T.O. not having mentioned in draft order submitted to the I.A.C. u/s 144B of the Act about initiating penalty proceedings u/s 273(A) and u/s 271(1)(a) of the Act, no order for initiation of the said penalties could have been made in the final order passed thereafter with prior approval of the Inspecting Assistant Commissioner of Income-tax?"

2. The facts, in a nutshell, giving rise to the present reference are as under:-

2.1 The respondent-assessee filed a return of income stating that the assessee firm had incurred a loss of Rs. 60,572/- for the Assessment Year 1979-80. The Assessing Officer issued notice under section 143(2) of the Act and after hearing the assessee's representative and upon perusal of the books of account, came to a conclusion that the assessee firm was in fact having an income of Rs. 1,14,577. In the circumstances, in view of the provisions of sec. 144B of the Act, he prepared a draft of the proposed order of assessment ('draft order' for short) and forwarded the same to the assessee as per the provisions of sec. 144B(1) of the Act.

2.2 The assessee had forwarded his objections, which were submitted to the Inspecting Assistant Commissioner ('IAC' for short) and, ultimately, after hearing the assesssee's representative and considering the objections, the draft order was approved by the IAC and it was forwarded to the Assessing Officer so as to enable him to complete the assessment on the basis of the draft order.

2.3 In the draft order, the Assessing Officer did not make any mention with regard to the interest payable by the assessee under the provisions of sections 139(8) and 217(1A) of the Act. Moreover, he also did not make any reference to initiation of penalty proceedings under section 274 read with sections 273(2)(a) and 271(1)(a) of the Act. However, in the final order, the Assessing Officer directed the assessee to make payment of interest under the provisions of sec. 139(8) and sec. 217(1A) of the Act and he also gave a direction with regard to issuance of a show-cause notice for imposition of penalty under section 274 read with sections 273(2)(a) and 271(1)(a) of the Act.

2.4 The assessee filed a Rectification Application under the provisions of section 154 of the Act for rectification of the final assessment order because the draft order did not mention anything with regard to payment of interest and issuance of a show-cause notice. According to the assessee, the Assessing Officer could not have levied interest or issued a show-cause notice for imposition of penalty as there was no mention about

the same in the draft order after it was approved by the IAC. The rectification application was rejected by the Assessing Officer by observing that no variation was made in the income assessed and mentioned in the draft order. It was also observed by the Assessing Officer that the draft order was not a final order and as the draft order related to computation of income only, any order passed with regard to payment of interest or issuance of a show-cause notice to the assessee in the final order cannot be treated as a variation in the draft order.

2.5 Being aggrieved by the order passed on the rectification application, the assessee filed an appeal before the CIT (Appeals). The CIT (Appeals) dismissed the appeal by observing that the final order passed by the Assessing Officer was not contrary to the provisions of sec. 144B of the Act and there was no provision for challenging an order charging interest by filing an appeal.

2.6 Being aggrieved by the order passed by the CIT (Appeals), the assessee preferred an appeal before the Income Tax Appellate Tribunal. The Tribunal allowed the appeal by observing that the Assessing Officer could not have made any change in the draft order, which was forwarded to the assessee and which was approved by the IAC. It was observed by the Tribunal that there was a violation of the principles of natural justice because the assessee did not get any chance to make a representation against the levy of interest and issuance of a show-cause notice because in the draft order the said facts were not stated by the Assessing Officer.

2.7 In view of the facts stated hereinabove, the questions referred to this court are to be considered. The question is whether it would be open to the Assessing Officer to make any change in the draft order even in the nature of levy of interest or issuance of a show cause notice for imposition of penalty after the drft order is approved by the IAC?

3. Before dealing with the question, one has to look at the provisions of sec.144B of the Act, which were in force at the relevant time. The said section is reproduced hereinbelow:-

"144B. (1) Notwithstanding anything contained in this Act, where, in an assessment to be made under sub-section (3) of section 143, the Income tax Officer proposed to make any variation in the income or loss returned which is prejudicial to the assessee and the amount of such variation exceeds the amount fixed by the Board under sub-section (6), the Income-tax Officer shall, in the first instance, forward a draft of the proposed order of assessment (hereafter in this section referred to as the draft order) to the assessee.

(2) On receipt of the draft order, the assessee may forward his objections, if any, to such variation to the Income-tax Officer within seven days of the receipt by him of the draft order or within such further period not exceeding fifteen days as the Income-tax Officer may allow on an application made to him in this behalf.

(3) If no objections are received within the period or the extended period aforesaid, or the assessee intimates to the Income-tax Officer the

acceptance of the variation, the Income-tax Officer shall complete the assessment on the basis of the draft order.

(4) If any objections are received, the Income-tax Officer shall forward the draft order together with the objections to the Inspecting Assistant Commissioner and the Inspecting Assistant Commissioner shall, after considering the draft order and the objections and after going through (wherever necessary) the records relating to the draft order, issue, in respect of the matters covered by the objections, such directions as he thinks fit for the guidance of the Income-tax Officer to enable him to complete the assessment :

Provided that no directions which are prejudicial to the assessee shall be issued under this sub-section before an opportunity is given to the assessee to be heard.

(5) Every direction issued by the Inspecting Assistant Commissioner under sub-section (4) shall be binding on the Income-tax Officer.

(6) For the purposes of sub-section (1), the Board may, having regard to the proper and efficient management of the work of assessment, by order, fix, from time to time, such amount as it deems fit :

Provided that different [amounts maybe fixed for different areas :

Provided further that the amount fixed under this sub-section shall, in no case, be less than twenty-five thousand rupees.

(7) Nothing in this section shall apply to a case where an Inspecting Assistant Commissioner exercises the powers or performs the functions of an Income-tax Officer in pursuance of an order made under section 125 or section 125A.

4. Learned Advocate Shri Qureshi appearing for the revenue has submitted that as per the provisions of sec. 144B(1) of the Act, the Asssessing Officer has to forward a draft order when he proposes to make any variation in the income or loss returned by the assessee which is

prejudicial to the assessee and when the amount of such variation exceeds the amount fixed by the Central Board of Direct Taxes under sec. 144B(6) of the Act. At the relevant time the Board had fixed a sum of Rs. 1 lac under sec.144B(6) of the Act and as in the instant case, the difference between the amount of loss returned by the assessee and the income assessed by the AO was more than Rs. 1 lac, the AO had forwarded the draft order to the IAC.

5. The learned advocate has submitted that as per the provisions of sec. 144B(1) of the Act, the draft order is to be forwarded to the IAC only when the AO proposes to make any variation in the income or loss returned which is prejudicial to the assessee. As the said section does not refer to the levy of interest or imposition of penalty, it was not necessary for the AO to stick to the draft order which was forwarded by him to the assessee and it was open to the AO to make a change in the draft order by levying interest or imposing penalty. It has been submitted by him that interest under the provisions of sec. 139(8) of the Act is consequential in nature and it is obligatory on the part of the AO to levy interest when the return is filed late. As the levy of interest is a necessary corollary to filing of the return after the specified date and as sec. 144B of the Act does not refer to the levy of interest, the change made by the AO in the draft order would not vitiate the validity of the assessment order though the change was made by the AO.

6. He has relied upon the judgment delivered in the case of CIT, Gujarat-I v. Ramjibhai Hirjibhai & Sons, 110 ITR 411, to substantiate his argument that it is obligatory on the part of the ITO to levy interest under the provisions of sec. 139 of the Act if the assessee fails to furnish his return before the specified date. He has also relied upon the judgment delivered in CIT v. Tiwary Bechar and Co., 165 ITR 78 to show that the AO has no discretion in the matter of levy of interest under the provisions of sec. 139 when there is delay in filing the return by the assessee. He has also submitted that a similar view was expressed in the case of Golecha Properties (P.) Ltd. v. CIT, 171 ITR 47.

7. It has been submitted by him that so as to complete the assessment on the basis of the draft order it was necessary for the AO to levy interest as it was obligatory on his part to do so as per the provisions of sec. 139 of the Act and as held in the judgments referred to hereinabove. In the circumstances, the levy

of interest in the final order is not at all illegal or violative of the provisions of soec. 144B of the Act.

8. It has been thereafter submitted by him that so far as issuance of a show cause notice under the provisions of sec. 274 read with sections 273(2)(a) and 271(1)(a) of the Act is concerned, as sec. 144B of the Act refers only to variation in the income or loss and as the section is silent with regard to imposition of penalty or any other consequential action which might have to be taken by the AO, mention of a direction with regard to issuance of a show cause notice in the final assessment order cannot adversely affect the validity of the assessment order. It has been further submitted by him that before issuance of such a show-cause notice, it is not necessary for the AO to hear the assessee because in reply to the notice it is open to the assessee to state the reasons for which the penalty should not be imposed.

9. It has been further submitted by learned advocate Shri Qureshi that penalty proceedings can be initiated either during the assessment or after completion of the assessment. He has relied upon the judgment delivered in case of D.M. Manasvi v. CIT, Gujarat II, 86 ITR 557, to substantiate the submission. He has submitted that in the instant case, in the course of the assessment, the AO thought of imposing penalty and, therefore, a show-cause notice had been issued. The AO could have recorded his satisfaction for initiation of penalty proceedings during the process of assessment and could have issued the show-cause notice even after the completion of the assessment. In such an event, the assessee could not have raised any objection and therefore Shri Qureshi has submitted that issuance of the show cause notice cannot be held to be violative of the provisions of sec. 144B of the Act.

10. It has been thereafter submitted by the learned advocate for the revenue that, by virtue of the changes made in the draft order by the AO, no harm or injustice was caused to the assessee for the reason that the assessee could have submitted an application for waiver of interest and it could have also given a reply to the AO stating the reason as to why penalty should not be imposed upon it. He has relied upon the observations made in case of Central Provinces Manganese Ore Co. Ltd. v. CIT, 160 ITR 961. As per the law laid down by the Hon'ble Supreme Court in the said case, according to Shri Qureshi, the assessee can always submit his application for reduction or waiver of interest under sec. 139(8) of

the Act. Even after the levy of interest, if the assessee had submitted such an application to the AO, the AO, after considering the facts and circumstances of the assessee's case, could have either reduced or waived the interest which was levied by virtue of the final assessment order.

11. Lastly, Shri Qureshi has submitted that the assessment made by the AO is not a nullity. At the most there is a mere irregularity in the order and therefore the said irregularity would not affect the validity of the assessment. To substantiate the above submission he has relied upon the majority view expressed in case of Sarabjit Singh v. CIT, 234 ITR 641.

12. On the other hand, learned advocate Shri R.K. Patel appearing for the assessee has mainly submitted that, as per the provisions of sec. 144B of the Act, no change can be made by the AO after the draft order is approved by the IAC. It has been submitted by him that the entire object behind enacting the said section would be frustrated if the AO is permitted to make any change in the draft order after it is approved by the IAC. In the instant case, the assessee had objected to the draft order and the objections were duly considered by the IAC and he had overruled the objections. Ultimately, the IAC did not issue any direction to the AO for making any change in the draft order, meaning thereby that the IAC had approved the draft order and therefore the draft order ought not to have been changed by the AO.

13. It has been submitted by learned advocate Shri Patel that the intention behind enactment of the said section was to see that the assessee comes to know about the liability incurred by him with regard to payment of tax, penalty, interest etc. for a particular assessment year. Once the assessee comes to know that his liability has been determined by the AO, which has been approved by the IAC, the AO should not make any change in the liability of the assessee. In the instant case, according to Shri Patel, the liability as determined under the draft order had been substantially enhanced by the levy of interest. According to him, the provisions of sec. 144B of the Act do not permit the AO to make even the slightest change in the draft order after it is approved by the IAC.

14. So far as the levy of interest is concerned, it has been submitted by Shri Patel that, it is an integral part of the assessment as held by the Hon'ble Supreme Court in case of Central Provinces Manganese Ore Co.

Ltd. v. CIT, 160 ITR 961. He has therefore submitted that, as the levy of interest is part of the assessment, after the draft order has been finalised by the IAC, the AO cannot levy interest because by doing so he would be making a change in the assessment.

15. He has also submitted that by not levying interest in the draft order, the AO had impliedly waived the levy of interest because the levy of interest is a matter of discretion of the AO. He has relied upon the judgment delivered in case of CIT v. Gordhanbhai Jethabhai, 205 ITR 279 to show that once interest is not levied in the assessment order, it is not open to the authority to rectify the assessment order by levying interest subsequently.

16. Thereafter he has submitted that even while passing a draft order, the AO has to determine the income or loss of the assessee and the amount of tax which is to be paid by him and in the process of doing so, he is making an assessment. Thus, for all practical purposes, the assessment is finalised by the AO while making a draft order and therefore the AO cannot make another assessment after the draft order is approved by the IAC. He has relied upon the judgment delivered in the case of Panchmahal Steel Ltd. v. U.A. Joshi, ITO, & Anr. 210 ITR 723, by this court. The said view was affirmed in appeal by the Supreme Court in Panchmahal Steel Ltd. v. U.A. Joshi, ITO & Anr., 225 ITR 458.

17. He has further submitted that it is also a normal practice of the department to incorporate the levy of interest in the draft order. The said fact with regard to normal practice could not be denied by the revenue and, according to Shri Patel, there was no reason for the AO to digress from the normal practice by levying interest after the draft order was finalised.

18. Even with regard to a direction for issuance of a show-cause notice to the assessee regarding imposition of penalty incorporated in the final assessment order, it has been submitted by the learned advocate appearing for the assessee that such a direction could not have been issued after the draft order was approved by the IAC. By adding a direction with regard to issuance of a show-cause notice, the AO had made a substantial change in the assessment order and the said change could have resulted into additional liability on the part of the assessee if ultimately penalty is imposed and therefore even a direction for issuance of a show cause notice could not have been incorporated in the final order.

19. We have heard the learned advocates and have considered the facts of the case in the light of the provisions of sec. 144B stated hereinabove. Before dealing with the questions, let us look at the object with which the said section was enacted in pursuance of a recommendation made by Wanchoo Committee. The relevant portion of the report of the committee is as under:-

"As regards disputed additions in assessment, a point has been made before us that often decisions are taken by the Income-tax Officer behind the assessee's back and the assessee comes to know of additions and disallowances only after the assessment has been made and an order is received by him. In many cases, the dispute could have been avoided if adequate opportunity had been given to the taxpayer to explain the position. We are aware that such situations do frequently arise. To ensure that the assessee gets a reasonable opportunity of meeting the objections of the Income-tax Officer before an assessment is finalised, we recommend that there should be a provision in the law requiring the Income-tax Officer to send a draft assessment order to the assessee,....."

Thus, looking to the provisions of section 144B of the Act in the light of the object with which it was enacted, it is very clear that the intention of the Legislature was to see that the assessee gets an opportunity to represent his case on the changes which might be made by the AO in the returned income or loss. If the objections of the assesee to the proposed changes are genuine, it would not only result into reduction in litigation but would also obviate undue hardship of the assessee because in that event the IAC would direct the AO not to make the proposed changes. Provisions of the section would also prevent the AO from passing a rash, arbitrary or vindictive order because the draft order is forwarded to the IAC, who has to consider the same in the light of the objections which might be filed by the assessee as per the provisions of sec. 144B(2) of the Act. Thus, the section ensures fair-play to the assessee as he can represent his case before the Department before he gets the final assessment order. By virtue of the said section, area of dispute between the AO and the Department can also be reduced because, if the AO makes any error, the IAC can give necessary directions to the AO and as the said directions are binding upon the AO as per the provisions of sec. 144B(5) of the Act, the chances of revising the order of the AO by the Commissioner are also substantially reduced.

20. Thus, it is very clear that by virtue of this section, in certain circumstances, the Legislature wanted the assessee to get an opportunity to represent his case before the final assessment is made.

21. Looking to the object with which section 144B has been enacted, it is very clear that the assessee should get an opportunity to represent his case before the revenue in the event of substantial change being made in his liability. Had the assessee got an opportunity to know the fact that interest was being levied, he could have made a representation to the IAC stating the reasons for which the interest ought not to have been levied. Moreover, had he known about the direction for issuance of a show-cause notice for imposition of penalty, the assessee could have made a representation and could have stated as to why even such a show-cause notice should not be issued. In fact, the assessee was deprived of this opportunity as the said facts were not incorporated in the draft order which was approved by the IAC. There are all chances that the IAC could have taken a different view in the matter of levy of interest or initiation of penalty proceedings after hearing the assessee. Once again, if we look at the object, the object is to reduce litigation and to give an opportunity to the assessee to represent his case before the final assessment is made. The said purpose would not be fructified if the assessee is not informed with regard to the levy of interest or initiation of penalty proceedings in the draft order.

22. Apart from frustration of the object, as stated hereinabove, the Hon'ble Supreme Court has observed in Central Provinces Manganese Ore Co. Ltd. (supra) that calculation of interest is part of the assessment and, therefore, while giving a direction with regard to levy of interest in the final order, the AO had decided to increase the assessment to the extent to which the interest was levied. Thus, in fact, the draft order was varied by the AO though no direction was given by the IAC under sec. 144B(4) of the Act to the AO. It was not open to the AO to make any change in the draft order unless there was any direction by the IAC under sec. 144B(4) of the Act. Thus, the AO had definitely made an error while making a change in the draft order after its approval by the IAC by levying interest while making the final assessment.

23. Moreover, there is also substance in the submission of learned advocate Shri Patel that the AO is having discretion with regard to levy of interest. If

the AO exercises his discretion by not levying interest in the draft order, he cannot be permitted to change the draft order subsequently by levying interest in the final order. It has been held in Gordhanbhai Jethabhai (supra) that if in the assessment order the AO does not levy any interest, it would be presumed that the AO has exercised his discretion in favour of the assessee by not levying interest. Subsequently, the AO cannot change his views by levying interest by changing the draft order. If interest is not levied at the first instance while making the assessment, the AO cannot levy interest subsequently by having recourse to the provisions of rectification. Even in the instant case, in the draft order as the AO did not mention anything with regard to the levy of interest, the assessee can very well presume that the AO had exercised his discretion in favour of the assessee by not levying interest. Such a decision or such an exercise of discretion cannot be changed by the AO after the draft order is approved by the IAC.

24. This Court has also decided in Panchmahal Steel (supra) that after the draft order is passed, a revised return cannot be filed by the assessee because once a draft order is made by the AO and the same is submitted to the IAC along with the objections of the assessee, the function of the AO is practically over. This Court has held that while passing a draft order, the AO has to determine the income or loss of the assessee and the amount of tax payable by him. Even though the said draft order is subject to scrutiny of a higher officer, the draft order is practically final so far as the AO is concerned. Unless there is a direction from the IAC under sec. 144B(4) of the Act, the said draft order cannot be changed by the AO and even the assessee cannot file a revised return after he is informed about the draft order. The said view has been upheld by the Hon'ble Supreme Court in Panchmahal Steel (supra).

25. Learned Advocate Shri Qureshi has submitted that it would be open to the assessee to make a representation before the AO in the matter of levy of interest. He has relied upon the case of Central Provinces Manganese Ore (supra) wherein the Hon'ble Supreme Court has observed that even if interest is levied, the assessee can represent before the AO against the levy of interest and the AO can consider the representation and it is open to him to delete the levy or reduce the interest. It is true that such a representation can be made. But, in the instant case, by making a change in the draft order, the AO has violated the mandatory provisions of sec. 144B of the Act. So far as the judgment of the Hon'ble Supreme

Court in the case of Central Provinces Manganese Ore (supra) is concerned, it did not pertain to draft assessment order. The question in the said case was only with regard to levying interest and making a representation against the levy of interest by the assessee. If the assessee is asked to make a representation and to litigate thereafter, as stated hereinabove, the entire object with which the said section had been enacted would be frustrated. It would not be in the interest of the assessee or the department to permit the AO to make such changes after the draft order is approved by the IAC. We, therefore, do not find any substance in the submission that the assessee can make a representation against the interest even after the final assessment order is made.

26. For the reasons stated hereinabove, we are of the view that the AO could not have made any change in the draft order by levying interest at the time of making the final assessment.

27. Even with regard to the second question pertaining to issuance of a show cause notice, we are of the view that the AO ought to have stated the said fact in the draft order if he had decided to initiate penalty proceedings. It is a settled legal position that in the course of the assessment the AO has to satisfy himself and decide whether penalty proceedings should be initiated. If, during the course of the proceedings he had been satisfied with regard to initiation of the penalty proceedings, he ought to have incorporated the said fact in the draft order so that the assessee and the IAC could have known about the said intention. The assessee could have made a representation before the IAC that there was no case for initiation of penalty proceedings. It is true that the assessee could have replied to the show cause notice and in such a case the AO could have taken a decision with regard to not initiating penalty proceedings but even in such a case, the object with which section 144B had been enacted would have been frustrated. As stated hereinabove, the Legislature wanted the assessee to get an opportunity to represent his case before passing a final assessment order. The said object has been frustrated here because even after the final assessment order, the litigation would continue and that would put the assessee to harassment and that would also increase the work-load of the department.

28. The reasons which have been recorded hereinabove with regard to levy of interest would also apply to the

issue with regard to direction to issue show cause notice. We therefore hold that it was not open to the AO to add a direction with regard to issuance of a show cause notice in the final assessment order in view of the mandatory provisions of sec. 144B of the Act.

29. It is also pertinent to note that the provisions of sec. 144B of the Act have been held to be mandatory. Though it is a procedural section, it is obligatory on the part of the AO to adhere to the said provisions while passing the final assessment order. The said view has been taken by majority of judges in the case of Sarabjit Singh (supra). Thus, by not following the said mandatory provision, the AO had committed breach of the said provision and therefore the Tribunal was absolutely right in setting aside the order passed by the AO so far as it pertained to giving a direction for issuance of a show cause notice for imposition of penalty.

30. In the circumstances, we answer both the questions in the affirmative, i.e., in favour of the assessee and against the revenue. The Reference stands disposed of accordingly with no order as to costs.

———

(R.K. Abichandani, J.)

(A.R. Dave, J.)

(hn)